Attorney General
Betty D. Montgomery

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September 3, 1998

Office of the Secretary
Magalie R. Salas
Federal Communications Commission
1919 M Street N.W. Room 222
Washington, D.C. 20554

Re: CC Docket No. 98-81

Dear Ms. Salas:

Enclosed, please find the original and ten copies of the Reply Comments of the Public Utilities Commission of Ohio in the above captioned docket number. Please time stamp one copy and return to me in the enclosed self-addressed, stamped envelope.

Thank you for your cooperation in this matter.

Respectfully submitted,

Jodi J. Bair

Jodi J. Bair
Assistant Attorney General
Public Utilities Section
180 E. Broad St., 7th Floor
Columbus, OH 43215
(614) 466-4396
(614) 644-8764

JJB/kja
Enc.
cc: Warren Firschein, Accounting Safeguards Division, CCB (diskette)

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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matters of	)	
	)	
1998 Biennial Regulatory Review -- Review of Accounting Cost Allocation Requirements	)))	CC Docket No. 98-81
	)	
United States Telephone Association's Petition for Rulemaking	))	ASD File No. 98-64

REPLY COMMENTS OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

INTRODUCTION AND BACKGROUND

The Public Utilities Commission of Ohio (Ohio Commission or PUCO) hereby submits its reply comments pursuant to the Federal Communication Commission's (FCC's) June 17, 1998, Notice of Proposed Rulemaking in CC Docket No. 98-81 and ASD File No. 98-64 (In the Matters of 1998 Biennial Regulatory Review—Review of Accounting Cost Allocation Requirements and United States Telephone Associations Petition for Rulemaking) (FCC 98-108). In its proceeding, the FCC invites public comment on certain proposed modifications to its current Part 32 and 64 rules.

In its reply comments, the Ohio Commission focuses mainly on Arthur Andersen's White Paper proposing radical changes to the FCC's current Part 32 and 64 reporting requirements. The Ohio Commission also expresses its concerns over the premature abandonment of Parts 32 and 64 reporting requirements for the adoption of generally accepted accounting principles (GAAP). The Ohio Commission acquaints the FCC with the current regulatory environment for local exchange carriers operating in the state of Ohio. In particular, the Ohio Commission familiarizes the FCC as to how the PUCO utilizes existing federal accounting and cost allocation rules to regulate the local exchange industry on an intrastate basis. Finally, the Ohio Commission responds to those commentors who maintain that the current regulatory accounting structure places an onerous obligation on incumbent local exchange carriers (ILECs). These comments are timely filed and due on September 4, 1998.

DISCUSSION

Overview:

The PUCO maintains that the FCC accounting and cost allocation rules are still necessary and relevant under the diverse systems of telecommunications regulation that exists at the state and federal levels. Telecommunications services pricing is an extraordinarily complex exercise in both inter and intra state jurisdictions. The assertions by the incumbent local exchange carriers that a new competitive regulatory paradigm exists, rendering the current uniform systems of accounts (USOA) and related accounting safeguards archaic, are simply false in Ohio and most other states at the local exchange market level. In fact, very little market penetration by new LECs at the local exchange level has been realized since the enactment of the 1996 Telecommunications Act. The Incumbent Local Exchange Carriers (ILECs) still control the local exchange market and the opportunity and incentive for cost allocation that would be disadvantageous to regulated customers still prevails. Rate setting methodologies for price caps, alternative regulation, and cost-based, rate-of-return regulation all have unique accounting and financial information requirements. The FCC separations rules in concert with Part 32 and Part 64 cost allocation rules provide the necessary accounting safeguards to ensure ILECs properly record and report revenues, expenses, and investment for their regulated, unregulated, interstate, and intrastate operations. The PUCO's reply comments dated September 9, 1996, Re: In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996, CC Docket No. 96-150, are still applicable in today's regulatory environment (see Attachment 1).

Many states still utilize cost-based, rate-of-return regulation to establish local exchange tariffs. In Ohio, all companies except Ameritech Ohio and Cincinnati Bell Telephone Company, have cost-based rates (over 6.5 million access lines served by over 40 local exchange carriers). Developing these rates would be virtually impossible to perform, for cost based companies, absent the detailed accounting and cost allocation rules currently in place. There is still a need for accounting information in its current form for states that may use alternative forms of regulation or price caps to establish intrastate rates. In Ohio, cost-based, rate-of-return analysis is one of several reasonableness tests employed when setting rates under a price caps or under an alternative regulation pricing regime. The FCC accounting and cost allocation rules provide consistency and uniformity of financial information, which is necessary under the various rate setting methods presently used in the state and federal jurisdictions.

The Ohio Commission maintains that Arthur Andersen's radical proposal to eliminate the FCC's current accounting and cost allocation rules in today's regulatory environment is premature. During this period of transition, from a regulated monopolistic environment to a competitive market, there still remains a practical need for cost-based financial information provided under the FCC's current Part 32 and 64 rules. If the FCC abandons the requirement that ILECs report this information, some state Commissions, Ohio's included, will continue to require Local Exchange Carriers (LECs) to report this indispensable information. The Ohio Commission recommends, therefore, that the FCC maintain its current requirements that states can uniformly utilize, rather than the alternative approach that would require each state Commission to establish its own (potentially different) requirements.

If the FCC decides that it should make some modifications to its current reporting requirements, the Ohio Commission recommends that the FCC employ a collaborative approach, which would involve all stakeholders, to evaluate the current accounting requirements consistent with current and future state and federal regulatory needs. Our goal should be to work together to balance the accounting needs of those state commissions still under rate base rate of return regulation with the needs of the FCC and state commissions using price caps. The Ohio Commission recommends that state and federal regulators work with the industry to develop meaningful financial information that reflects the realities of telecommunications regulation without unduly burdening the companies.

Current Regulatory Environment in Ohio:

The PUCO agrees with MCI (MCI Comments July 17, 1998, at 3) that "[t]he Commission should not relax accounting safeguards at a time when mid-sized LEC provision of competitive services is likely to increase substantially." This logic also applies to the large Class A LECs.

The competitive landscape in the local market has not changed dramatically. This is illustrated by the fact that no Regional Bell Operating Company (RBOC) has received 47 U.S. § 271 approval. The Ohio Commission is concerned with the potential for excessive allocation of charges to regulated service providers. An inappropriate allocation not only could over burden the regulated customers, but more importantly, could also have a negative impact on competition in other markets.

In Ohio, the price cap system is an alternative form of regulation that is subject to periodic review. Of the LECs operating in Ohio, 40 are subject to rate of return regulation, including Alltel Ohio, GTE, Sprint, and Western Reserve. Therefore, cost allocation requirements continue to be vital in determining fair and reasonable rates. In fact, in Ohio, substantial adjustments have been made during rate proceedings in regard to affiliated transactions. These adjustments would not have been possible without the detailed USOA information currently required.

Ameritech alleges that the USOA that was designed and adopted under traditional rate of return regulation, has evolved into a system that has no practical purpose because all large incumbent LECs are under a no-sharing price cap system in the federal jurisdiction and most companies are under alternative regulation with no cap on earnings in the state jurisdictions. Ameritech July 17 Comments at 8.

Contrary to Ameritech's assertion, most large and small incumbent LECs in Ohio are still under the traditional rate of return type regulation and are required to maintain their books and records in accordance with the USOA. Ameritech's "no practical purpose" position taken in this proceeding contradicts its position taken in the SBC/Ameritech merger application filed with the PUCO in Case No. 98-1082-TP-AMT. In the merger application, Ameritech argues that it will continue to follow the (Ohio) Commission's guidelines and rules, including but not limited to its Local Service Guidelines (PUCO requires USOA for all ILECs), Minimum Telephone Service Standards, accounting and affiliated transaction rules and other Commission requirements. Ameritech carefully points out that in committing to do so, the merger will not impede the PUCO's ability to regulate and effectively audit the intrastate operations of Ameritech Ohio. Also, the PUCO in establishing the wholesale price for resold services to be provided by ILECs, calculates the avoided costs for resale based upon specific USOA account codes. Ohio's Local Competition Guidelines specify that the wholesale prices shall be determined on the basis of the retail rates charged to subscribers for the telecommunications service under consideration, excluding the portions thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the ILEC.

In the discussion of the "Changing Need for Asset Management Information" on Page 30 of the White Paper, Arthur Andersen notes ". . . a shift in the form of regulation applied to dominant carriers by the FCC and the majority of State Commissions from traditional rate of return regulation to price cap regulation." While Ohio has allowed price cap regulation as part of the alternative regulation procedures available, only Ameritech is under true price cap regulation. Ameritech argues that since it follows price cap regulation, it should be released from USOA accounting under its "less compelling" proposal (Ameritech July 17 Comments at pages 12-13). However, this proposal would leave the single most dominant carrier in Ohio with control of the majority of bottleneck facilities in the most populous areas, and would provide the PUCO with vastly reduced information for tracking its activities and responses to competitors.

The fact that the USOA and CPR rules were "...designed under traditional rate of return regulation..." (White paper, Page 30) does not make it any less useful or necessary in monitoring dominant carriers during the transition to competition.

Concerns with USOA and GAAP:

One of the accounting changes offered by the ILECs is reliance on the principles of GAAP materiality standards, rather than following expense limits established by USOA. Application of a materiality standard relies upon the good judgement and professional expertise of the accounting practitioner. While this standard is appropriate for unregulated firms operating in a fully competitive business environment, this is not the best approach for a regulated industry where consistency and comparability of financial reporting is desired. Substituting a materiality standard for specified expense limits and value studies opens the door for very different accounting treatment of similar transactions. This would be particularly true with large LECs versus medium and small LECs. If such a materially standard were adopted, it would distort Return On Equity comparisons between LECs and other financial measurements commonly employed today.

ILECs also argue that, rather than requiring the reporting of detailed information on a regular basis, information should be requested by the staffs only on an "as needed" basis. Arthur Andersen LLP at 50.

In the transition towards a more competitive environment, Federal and State Commissions have been hard pressed to respond to issues in increasingly shortened timeframes. It has been our experience, that having to request detailed information dramatically delays and often inhibits the Ohio Commission's ability to timely process requests. Substituting GAAP for the detailed USOA accounting, thereby requiring regulators to data request USOA based information and studies, would only further serve to lengthen the investigation time and exacerbate the situation. Due to the tremendous flexibility afforded companies associated with keeping accounting records in accordance with Generally Accepted Accounting Principles, that method of record-keeping is inferior to USOA for the regulatory purposes that the Ohio Commission intends to use the information.

The potential problems and pitfalls of such a move at this time mandate rejection of this proposal. The Telecommunications Act of 1996 puts the onus upon the states to administer numerous provisions of the 1996 Act and the implementation. It is premature to eliminate or modify one of the major tools used to monitor and evaluate implementation. Further, the accounting detail is utilized in a multitude of regulatory functions such as local service pricing, jurisdictional separations, avoidable cost determination in wholesale pricing, unbundled network element costing, and is relied upon in affiliate transaction, cross subsidization and asset transfer analyses and investigations.

Ameritech comments that all ILECs should be subject to the same requirements as their competitors. Ameritech further maintains that its competitors utilize Generally Accepted Accounting Principles (GAAP) for purposes of record keeping. Ameritech July 17 Comments at 8.

Local Competition Guidelines prescribed by the PUCO require the accounting records to be maintained in accordance with the USOA for local telephone operations by all LECs. Unless the Commission requires a New Entrant Carrier (NEC) to use Class A USOA accounts, the NEC may utilize Class B USOA accounts. Furthermore, the ILECs "me too" arguments in an attempt to justify like treatments as a NEC are not credible. The Ohio Commission has previously stated that its guidelines reflect different treatment for ILECs and NECs in certain areas. However, to do so does not amount to discriminatory preference for the NECs. Symmetrical regulation is only appropriate when circumstances are symmetrical. ILECs remain the dominant carrier and continue to control essential bottleneck monopoly facilities such that the circumstances between ILECs and NECs are not perfectly symmetrical.

Ameritech and other large LECs believe that under price cap regulation, the cost of service concept on which the need for USOA detail was based is irrelevant and prices no longer bear a direct relationship to costs. Arthur Andersen LLP at 11.

The PUCO does not agree with those who suggest that any adjustment made to the regulated sector would have no impact in a price caps environment. In our opinion, FCC cost allocation changes can in turn significantly affect the LECs' total service long run incremental cost studies for loop plant services, and could further affect the requisite level of assistance necessary in high cost service areas. In particular, with the introduction of non-regulated services (such as video and advanced telecommunications services) using regulated loop plant, the costs allocated between regulated and non-regulated operations could be greatly effected. The PUCO notes that while there may not be a direct correlation between costs incurred and prices under a price cap rate setting scheme, decisions rendered by the FCC on accounting and other matters can have a significant impact on the pricing of services and regulatory review of a price cap company. Therefore, cost allocation changes must be taken into account for all LECs, regardless of the type of price regulation they may be subject to.

Additionally, the PUCO continues to require Long Run Service Incremental Cost (LRSIC) and where appropriate, imputation studies from its price caps company. Ameritech currently is the only LEC operating in Ohio under a true intrastate price cap plan for intrastate regulated retail services. The statutes in Ohio require the PUCO to analyze the costs for all of its regulated companies, including price cap companies. The cost information provided by Parts 32 and 64 will remain vital, specifically for review of the merits of Ameritech's replacement of its alternative regulation plan.

Ameritech proposes the elimination of asymmetrical affiliate transaction rules (Ameritech at pg. 3). This proposal is discussed in Attachment 1 to the comments (the Arthur Andersen paper) at pages 38-47. Ameritech proposes to modify Part 32 Accounting as it relates to the way affiliate transactions are recorded on the books of the regulated entity. The affiliate transaction rules were developed to provide assurance that the captive regulated ratepayer would not be subsidizing the affiliated company through inflated transfer prices. As the telecommunications industry transitions to competition, the issues of and assurances against cross subsidization are more pertinent than ever. The PUCO believes that the affiliate transaction rules, as currently written, should remain intact and the Ameritech proposal should be rejected.

Plant Accounting and Depreciation

The Large Local Exchange Companies (LLEC's) and Arthur Andersen's concerns are centered around the detail mandated through the use of USOA under Part 32, versus the detail that would be eliminated by the replacement with GAAP (Generally Accepted Accounting Principles). The detail referred to here and throughout these comments is the Basic Property Records (BPR) as outlined in Attachment 3, pages 26-28.

Ameritech Ohio, GTE, Cincinnati Bell, and a few other LLEC's have always contended that the PUCO relies too heavily on historical indications/trends in determination of the proper service life for the future. Although PUCO does rely upon historical trends, in the past 3-5 years more weight has been given to future expectations. This can be seen in many plant accounts where the Projection Life (Plife) proposed between the companies and the PUCO are relatively close. Also, the long drawn out negotiation meetings of the past have been shortened to less than 1 day, or in many instances, no meeting was required since the differences were almost inconsequential and were resolved in a telephone conversation. Should the requirement for the detailed plant records be eliminated, the companies will not be able to successfully defend any life projections in the future that differ from the regulator's projections. The burden of proof remains with the LEC's regardless of the accounting system used.

The detailed plant records are used, among other things, to calculate the adequacy of the depreciation reserve, *i.e.*, to calculate the theoretical reserve which in turn results in the amortization amount needed to true-up the companies' book reserve. Replacing the requirements of the USOA with GAAP will not permit the PUCO to perform this calculation and, therefore, any imbalance in the companies' reserve will remain so in perpetuity, or be written off.

Whether or not a LEC is under price caps or rate base rate of return regulation, the need for proper depreciation rates will still exist. Unless determined otherwise, the PUCO still has the authority to set the proper depreciation accrual rates on an intrastate basis for whatever purpose they are to be used. For at least some of the analyses, the availability of the plant accounting detail mandated by USOA will remain necessary.

The fact that Ameritech is one of the LLEC's that wants to eliminate the data requirements mandated by the USOA and replace them with reduced requirements of GAAP is not surprising. It was recently reported that a CPR audit of the regional bell operating companies by the FCC discovered an alleged $5 billion of plant assets which could not be located. A joint State-FCC audit encountered a similar problem with the continuing property record CPR audit of GTE in December 1997. The report indicated that 21.7% of the sampled investment was missing and another 14.6% of the investment sampled were unverifiable. *Joint Audit Report on the Basic Property Records of GTE Corporation's Telephone Operating Companies,* MBO/AAD No. 95-24 (December 1997).

As discussed elsewhere, the majority of ILECs in Ohio remain under traditional rate base rate of return regulation. It is important that as much standardization as possible be maintained between different companies, and that the differences between company record keeping systems be known in advance. This standardization helps to facilitate the processing of depreciation and other accounting matters before the PUCO in a timely manner. The White Paper asserts on page 26 that "[t]he requirement that LECs file all proposed changes to their BPR plan with the FCC limits carrier flexibility." The PUCO finds it odd that a simple <u>notification</u> requirement is considered a limit to a carriers flexibility. The Ohio Commission recommends that the FCC retain its notification requirement for changes to a BPR plan.

With regard to depreciation practices, and the discussion on pages 29 and 30 of the White paper, the assumption is made that price caps are ubiquitous. As previously indicated, this is simply not the case for intrastate operations. Arthur Andersen on page 30 of the White Paper states, "...the regulation of depreciation rates and methods has been critical to allowing the FCC and State regulators to accomplish their regulatory and universal service objectives." The Ohio Commission, agrees however, and wishes to emphasize that the universal objectives have not somehow miraculously evaporated at either the Federal or the State level. Although there may be need for changes, we are clearly in a period of transition with regard to those objectives, and these objectives, at this point, largely remain the same.

On page 31 of the White Paper, Arthur Andersen notes that the procedures described in Section 32.2000 does not provide information "beneficial to managing their assets or running their businesses". This, however, does not mean that these requirements should be thrown away. As the NPRM states on pages 3 and 4, these procedures are still important "...to monitor the large incumbent LECs <u>as competition begins to develop</u> in local telephony markets." The need for the detailed information remains. The provision of services to a non-regulated subsidiary at less than market rates is not the only way for cross-subsidization to occur. The same effect can be easily achieved by transferring physical assets to a subsidiary at inappropriate and discriminatory values. The only way to monitor for this possibility is the type of detailed transaction information contained in the current USOA and CPR requirements.

The Purported Burden Associated with Regulatory Accounting

Arthur Andersen pointed out that it is important that any revisions in the level of information requested from carriers by the FCC staff be coordinated with the state commissions. If a "streamlined" ARMIS procedure is adopted by the FCC, changes in the carriers' reporting processes to be responsive to such streamlining would likely result. However, if state commissions continue to require the reporting of ARMIS information at the current level, a layer of additional cost to the carrier would likely result. Instead of reducing the effort necessary to comply with regulatory oversight (in an increasingly competitive environment), more effort would be required. For this reason, coordination between the FCC and state commissions is clearly necessary. Arthur Andersen LLP at 51.

The PUCO wholeheartedly agrees that coordination between the FCC and state commissions is necessary. In fact, the FCC should initiate a joint proceeding involving interested states to further review changes and the streamlining of USOA accounting. However, if Arthur Andersen's recommendations are adopted by the FCC, each state commission would likely be forced to require its own detailed accounting in order to meet its state's specific regulatory obligations. This could result in a very inefficient state by state patchwork of accounting systems costing even more than the current levels. For Ameritech, which operates in a five-state region, maintaining an accounting system prescribed by each state would certainly be a much greater burden than the current USOA now employed and prescribed by the FCC.

The discussion on "Comparison With Other Industries" and the associated chart (White Paper, Pg. 32) are interesting, but lack information needed to assess truly how comparable these companies are. The White Paper states that "...the LECs are saddled with extremely high costs to manage their fixed assets due to the detailed requirements of Section 32.2000." (White Paper, Pg. 32) While some of these costs may be attributable to Section 32.2000, far more of these costs are attributable to the fact that an ILEC is a capital intensive entity. As an example, Ameritech's 1997 Annual report shows approximately $34 billion in plant in service. Based on the costs shown in the chart on Page 32 of the White Paper, this would indicate that Ameritech spends between $0.0001 and about $0.0003 per dollar of fixed asset on tracking and depreciation. This is not an unreasonable expenditure.

Ohio Commission Recommendation:

Any rapid move to GAAP accounting is premature, the burden on large LECs is grossly exaggerated, and the statement that competition is thriving is false. One of the ongoing responsibilities of the FCC, and the state commissions, is to monitor the development of competition, determine when competitive markets are truly in place, and prevent those competitive markets from being stifled in their formative stages by the power of the incumbent. It is for this reason that the USOA should remain in place. Certainly modifications of the existing USOA may be in order as we continue on towards competition, but at this time a major overhaul of the USOA, based on the belief that competition is here without any validation, is premature.

The PUCO recommends a collaborative method for analyzing the need to alter the current accounting and cost allocation requirements. The collaborative method would seek to bring all interested parties together to evaluate how to balance the accounting needs of those state commissions still under rate base rate of return regulation with the needs of the FCC and state commissions using price caps. This method could foster constructive dialogue, with all parties gaining an appreciation for the regulators needs, as well as the burden placed on the LECs. It should be noted that a similar process was implemented (and is ongoing) by National Association of Regulatory Commissions (NARUC) to develop cost allocation guidelines for the energy industry involving all stakeholders.

CONCLUSION

Accordingly, the PUCO urges the FCC to incorporate the above reply comments into its decision in this proceeding. The PUCO wishes to thank the FCC for the opportunity to file reply comments in this proceeding.

Respectfully submitted,

Betty D. Montgomery
Attorney General

Jodi J. Bair

Jodi J. Bair
Assistant Attorney General
Public Utilities Section
180 East Broad Street
Columbus, OH 43215-3793
(614) 466-4396
FAX: (614) 644-8764

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996	)))))))	CC Docket No. 96-150

EXECUTIVE SUMMARY OF THE REPLY COMMENTS OF THE PUBLIC UTILITIES COMMISSION OF OHIO

The PUCO completely concurs with the move toward competition in the telecommunications industry. Steady, unimpeded progress towards this goal requires that the integrity of the process is maintained and that all parties and stakeholders have confidence in the fairness of the results. With new and continually changing conditions, refined accounting safeguards such as those proposed by the FCC are required, but not diluted ones. Failure to provide confidence and assurance to core customers will itself impede progress toward competition. It is not a question of more regulation or less regulation, but one of appropriate regulation, that is critical in managing the transition to a competitive telecommunications industry.

Contrary to the argument that price caps regulation obviates the necessity to have strict controls, the need for accounting controls and audit trails are even more imperative at the present. The various price caps systems are, in fact, experiments which are subject to review at periodic intervals. The validity of these experiments requires appropriate accounting systems and audit trails to make meaningful comparisons. Additionally, an overallocation of joint and common costs to the local exchange operations could result in inflated prices for cost-based interconnection, since rules promulgated by the FCC in CC Docket No. 96-98 establish that an appropriate allocation of joint and common costs is to be recognized in total element long run incremental cost (TELRIC) studies establishing interconnection rates.

The PUCO believes that permitting the State commissions to assist in the audit planning process would result in a more comprehensive work product and would obviate the need for State commissions to conduct parallel audits. State commissions also need the flexibility to implement intrastate accounting rules based on their rate setting regime and regulatory laws.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of the	)	
Telecommunications Act of 1996:	)	CC Docket No. 96-150
	)	
Accounting Safeguards Under the	)	
Telecommunications Act of 1996	)	

REPLY COMMENTS OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

INTRODUCTION

The Public Utilities Commission of Ohio (PUCO) hereby submits its reply comments pursuant to the Federal Communications Commission's (FCC's) Notice of Proposed Rulemaking (NPRM) in CC Docket No. 96-150 (In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996. Specifically, the FCC's NPRM in this proceeding is proposing rules to implement the accounting safeguard provisions of Sections 260 and 271 through 276 of the Telecommunications Act of 1996.) Those sections address Bell Operating Company (BOC) and, in some cases, incumbent local exchange carrier provision of particular telecommunications and information services.

The NPRM addresses the various accounting safeguards that Congress adopted in the 1996 Act to promote the development of competition in telecommunications markets while protecting subscribers of regulated monopoly services provided by the BOCs and, in some cases, other incumbent local exchange carriers against the risk of being forced to "foot the bill" for the carriers' entry into, or continued participation in, competitive services, and to promote competition in new markets by preventing carriers from using their existing market power in local exchange services to obtain an anti-competitive advantage in those new markets the carriers seek to enter.

By way of these reply comments, the PUCO submits its recommendations concerning the necessity for continued application of accounting safeguards, the structure for compliance audits contemplated in the 1996 Act, and the FCC's jurisdiction in intrastate accounting matters.

Necessity of Accounting Safeguards

The PUCO completely concurs with the move toward competition in the telecommunications industry. It should be noted that steady, unimpeded progress towards this goal requires that the integrity of the process is maintained and that all parties and stakeholders have confidence in the fairness of the results. In these circumstances, with new and continually changing conditions, refined accounting safeguards such as those proposed by the FCC are required, but not diluted ones. Failure to provide confidence and assurance to core customers will itself impede progress toward competition. It is not a question of more regulation or less regulation, but one of appropriate regulation, that is critical in managing the transition to a competitive telecommunications industry. As discussed below, the accounting safeguards proposed by the FCC are necessary and appropriate.

The need for accounting controls and audit trails are even more imperative at the present, contrary to Ameritech's argument that price caps regulation obviates the necessity to have strict controls. The various price caps systems are, in fact, experiments which are subject to review at periodic intervals. The validity of these experiments requires appropriate accounting systems and audit trails to make meaningful comparisons. While Ameritech's intrastate rates are subject to a price caps regulation plan in Ohio, at the conclusion of this plan the PUCO will evaluate the efficacy of this type regulation. During the periodic review, financial performance measures, among other additional factors, may be taken into consideration by the PUCO. As a result, Ameritech could be incented to misallocate costs from its affiliate companies to local exchange regulated operations. Appropriate accounting controls are a means to dissuade and detect such activity. In further support of its position on this matter, the PUCO notes that Sprint Corporation indicated in its comments that "Under a pure Price cap regime, LECs would have little incentive to have their regulated services subsidize their non-regulated operations." Sprint also notes that "a pure price cap regime does not exist and cannot realistically be made pure. Thus, a price cap regime does not fully protect against anti-competitive activities." (Sprint comments at pages 16 and 17)

Additionally, as mentioned in our reply comments in CC Docket 96-149, an overallocation of joint and common costs to the local exchange operations could result in inflated prices for cost-based interconnection, since rules promulgated by the FCC in CC Docket No. 96-98 establish that an appropriate allocation of joint and common costs is to be recognized in total element long run incremental cost (TELRIC) studies establishing interconnection rates.

Lastly, the PUCO is keenly aware of the need for an audit trail and auditable records as a result of its participation in the federal/state joint affiliated transaction audit of Ameritech Services, Inc. conducted by the FCC, the Public Service Commission of Wisconsin (PSCW), and the PUCO. One of the audit's findings was that "ASI failed to provide sufficient written documentation to allow the audit team to analyze and substantiate, to the audit team's satisfaction, ASI's rationale for the apportionment of its costs between regulated and non-regulated AOC services."

That audit resulted in a Consent Decree Order in Docket AAD 95-75 whereby Ameritech agreed to maintain necessary records to justify allocating and recording costs to regulated accounts. The PUCO concurs and supports the recommendations by the PSCW (comment at pages 7 and 8) and MCI (comments at page 9) that Part 32 and 64 rules be modified to require carriers to maintain documentation to provide a complete audit trail of cost allocations and affiliate transactions. This documentation will assist and expedite the work of auditors who will perform annual compliance audits required by the 1996 Act.

Audit Requirements

The PUCO concurs with the recommendation of the Public Service Commission of Wisconsin (PSCW) that supports the NARUC resolution adopted July 25, 1996, which outlines the guidelines for the biennial audits required under Section 272 of the 1996 Act. This resolution, which the PUCO, PSCW, and several other State commissions developed in conjunction with the National Association of Regulatory Utility Commissioners (NARUC), would permit State commissions to have input in the scope, objectives and work plan of the audits, and not just receive information. The PUCO believes that permitting the State commissions to assist in the audit planning process would result in a more comprehensive work product and would obviate the need for State commissions to conduct parallel audits.

FCC Jurisdiction/State Pre-emption

The PUCO concurs with those commenters' objecting to the FCC pre-empting State commission jurisdiction in intrastate regulatory accounting matters. In particular, the PUCO agrees with those commenters, such as the PSCW, who have demonstrated that the FCC's tentative conclusion that it has jurisdiction over intrastate activities and therefore possesses the ability to prescribe intrastate cost allocation procedures and affiliated transaction rules is in error. Section 152(b) of Chapter 47 of the United States Code has not been repealed or modified in any way. Therefore, it was the clear intent of Congress to continue to reserve authority over intrastate matters to the states. Further, in Section 601(c)(1) of the 1996 Act, Congress expressly stated that "this Act and the amendments made by this Act shall not be construed to modify, impair, or supersede Federal, State or local law unless expressly so provided in such Act or amendments." These sections of the 1996 Act must be given meaning, and authority must be reserved to the States.

While the PUCO and many other State commissions subscribe to FCC accounting policies, practices, and procedures, there are situations where federal accounting practices could be inconsistent with State rules and rate setting policies. State commissions need the flexibility to implement intrastate accounting rules based on their rate setting regime and regulatory laws. The PUCO notes that it regulates over forty LECs. One company (Ameritech) has its intrastate rates established under a price cap regime. Two other LECs have rates established under alternative regulation rules promulgated by the PUCO, and the remaining companies' rates were established under traditional rate-of-return regulation. Different rate setting regimes may warrant different accounting prescriptions.

The Public Utilities Commission of Ohio also agrees with the comments of NARUC that the FCC should continue to work cooperatively with the States and to incorporate the recommendations of both NARUC and individual states in implementing the 1996 Act, and in particular in developing rules concerning accounting safeguards.